BARINGS

The ABCs of BDCs

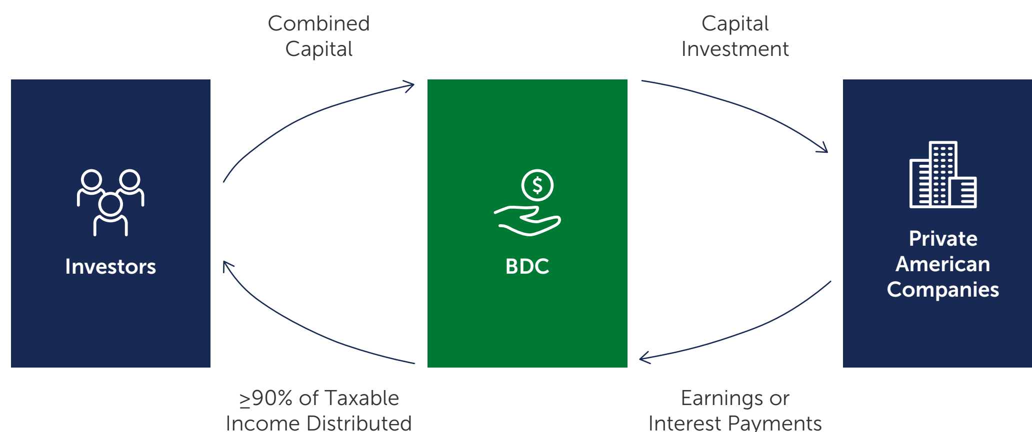
A BRIEF BUSINESS DEVELOPMENT COMPANY GUIDE

What is a BDC?

A business development company, or BDC, is a closed-end fund designed to lend to private middle market businesses. The BDC model was created in 1980, when the U.S. Congress modified the Investment Company Act of 1940 to facilitate private finance investments. Qualifying for BDC status requires quarterly SEC reporting and an independent board structure, which provide for a high degree of transparency and oversight.

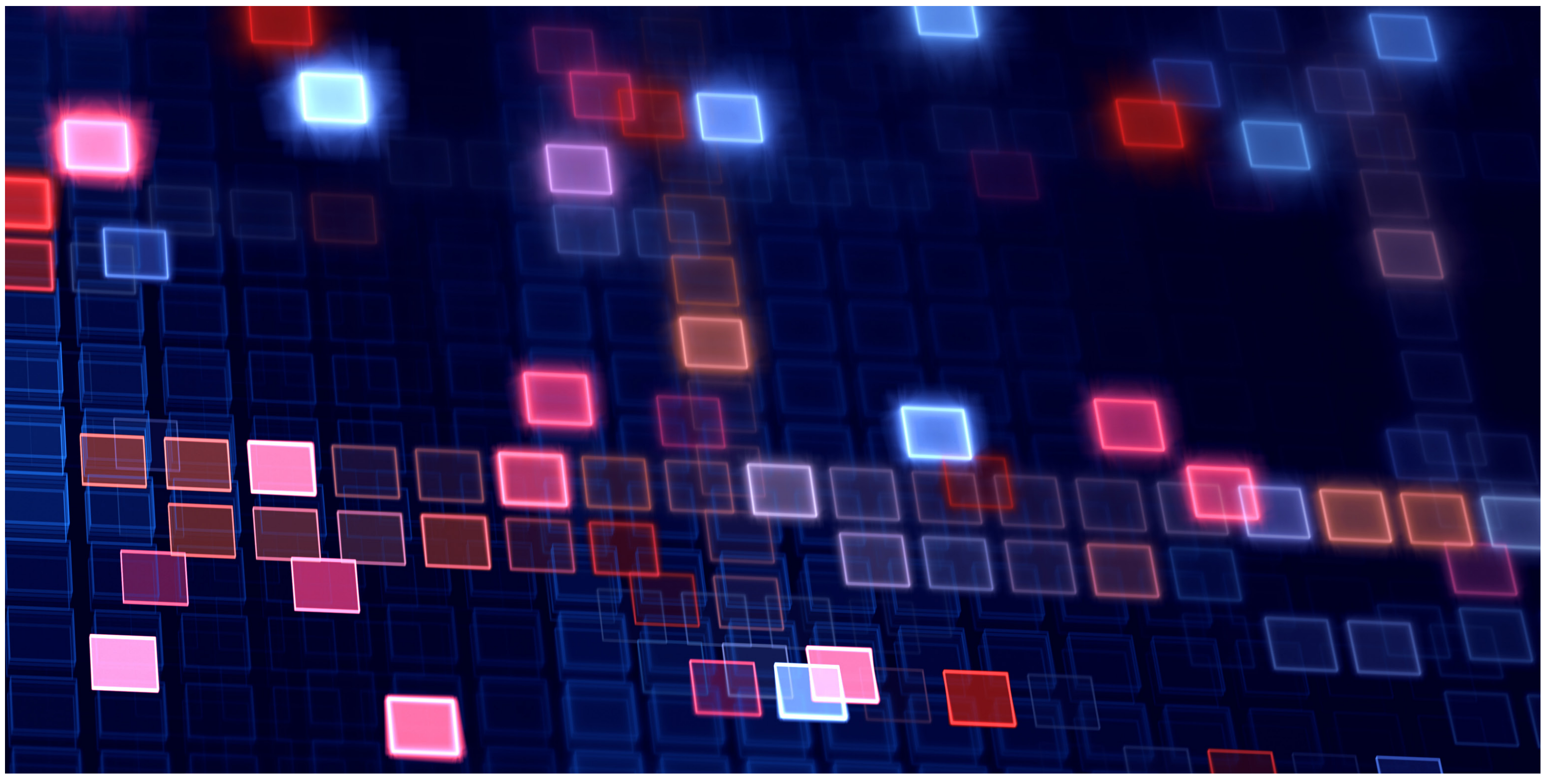
BDCs generally are organized as regulated investment companies (RICs), which are required to generate over 90% of income from capital gains, interest or dividends from investments. BDCs must invest at least 70% of assets in private U.S. companies or small public U.S. companies, which fall below $250 million in market capitalization.

FIGURE 1: SIMPLIFIED BDC MODEL



Source: KBW Research.

BDCs raise capital from institutional and individual investors and provide financing solutions to middle market businesses. BDC portfolios primarily consist of senior secured, floating-rate loans whose interest payments become income to the BDC. At least 90% of that taxable income must then be distributed to BDC shareholders. Because they generally are organized as RICs and pass almost all their income through to their shareholders (much like real estate investment trusts), BDCs typically pay no taxes at the corporate level. This pass-through feature is efficient and attractive for investors because it avoids the double taxation of BDC income that otherwise would occur at the fund level and at the shareholder level.



Types of BDCs

To access the asset class, investors have three choices: public, private, and perpetual. The main difference between the three BDC structures is liquidity:

- The shares of **public BDCs** are listed on an exchange where prospective investors can buy shares and shareholders can sell their ownership interest throughout the trading day. Public BDCs offer the most liquidity for shareholders, but also expose them to stock market volatility.
- **Private BDCs** are not listed on an exchange and therefore do not expose shareholders to market volatility. However, there is no liquidity in the private BDC structure until a liquidity event, such as when its assets mature or are sold.
- The **perpetual BDC** format solves for the volatility drawback of the public BDC format and the liquidity drawback of the private format by offering to redeem shares quarterly at their net asset value, or NAV.

FIGURE 2: BDC STRUCTURE

	Perpetual BDC	Private BDC	Public BDC
Fund Structure	Monthly Subscriptions/ Quarterly Redemptions	Closed/Private	Closed/Public Stock
Liquidity	Generally 5% of Total Fund NAV Quarterly	No Liquidity Until Liquidity Event	Exchange-traded

Source: Barings LLC.

The Case for a BDC Allocation

Due to their structure and the nature of their investments, BDCs may by worthy of consideration for investors. The following are five potential benefits of a BDC investment:

DOWNSIDE PROTECTION POTENTIAL

BDC assets tend to be senior secured debt of core middle market companies. The nature of the debt historically has provided significant investor protection at the top of the capital structure.

DIVERSIFICATION

Returns on BDC portfolio investments have historically shown low correlation to public equity or fixed income market returns.

INCOME

Because of their requirement to pass-through most income, BDCs potentially can generate higher income than equity dividends or fixed income coupons. The Cliffwater Direct Lending Index, which measures the performance of U.S. middle market corporate loans as represented by the asset-weighted performance of the underlying assets of BDCs, has averaged >9% since its inception in 2005.[1]

INFLATION HEDGE

BDC portfolios generally consist of floating-rate loans that generate higher income as interest rates and inflation rise.

GOVERNANCE ACCOUNTABILITY

Quarterly SEC filings and independent boards provide investors with a high degree of transparency and oversight.

FIGURE 2: BENEFITS OF A BDC

Downside Protection	Primarily senior secured exposure with financial covenants in the core middle market driving significant lender protection at the top of the capital structure.
Diversification	BDC portfolio investment returns are less correlated to public markets. BDC allocation offers the opportunity to increase investor portfolio returns without increasing risk.
Income	BDC portfolio investments potentially generate premium returns relative to public markets. Cliffwater Direct Lending Index has averaged 9.4% since 2005 inception.
Inflation Hedge	BDC portfolios generally consist of floating rate corporate loans that generate higher income returns as interest rates/inflation increase.
Transparency/Oversight	Extremely high degree of transparency with quarterly SEC filings and independent boards.

Source: Barings LLC.

1. Source: Cliffwater. As of March 31, 2023.

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Investing in our common stock involves a number of significant risks. Before you invest in our common stock, you should be aware of various risks, including those described below. You should carefully consider these risk factors, together with all of the other information included or incorporated by reference in the Private Placement Memorandum, before you decide whether to make an investment in our common stock. The risks set out below are not the only risks we face. Additional risks and uncertainties not presently known to us or not presently deemed material by us may also impair our operations and performance. If any of the following events occur, our business, financial condition, results of operations and cash flows could be materially and adversely affected. In such case, the net asset value of our common stock could decline, and you may lose all or part of your investment.

Please read the prospectus carefully for a description of the risks associated with investing in BPCC. These risks include, but are not limited to, the following:

Our investments in portfolio companies may be risky, and we could lose all or part of our investment. The lack of liquidity in our investments may adversely affect our business. Price declines and illiquidity in the corporate debt markets may adversely affect the fair value of our portfolio investments, reducing our net asset value through increased net unrealized depreciation. Our failure to make follow-on investments in our portfolio companies could impair the value of our portfolio. Our portfolio companies may incur debt that ranks equally with, or senior to, our investments in such companies and such portfolio companies may not generate sufficient cash flow to service their debt obligations to us. There may be circumstances where our debt investments could be subordinated to claims of other creditors or we could be subject to lender liability claims. Second priority liens on collateral securing loans that we make to our portfolio companies may be subject to control by senior creditors with first priority liens. If there is a default, the value of the collateral may not be sufficient to repay in full both the first priority creditors and us. Our investments in foreign companies may involve significant risks in addition to the risks inherent in U.S. investments.

If we do not invest a sufficient portion of our assets in qualifying assets, we could fail to qualify as a business development company or be precluded from investing according to our current business strategy. We are a non-diversified investment company within the meaning of the 1940 Act, and therefore we have additional flexibility to focus our investments in a limited number of portfolio companies. We generally will not control our portfolio companies. Economic recessions or downturns could impair our portfolio companies and harm our operating results. Prepayments of our debt investments by our portfolio companies could adversely impact our results of operations and reduce our return on equity. Potential write-downs or losses with respect to portfolio investments existing and to be made in the future could adversely affect our results of operations, cash flows, dividend level, net asset value and stock price.

Any unrealized losses we experience on our loan portfolio may be an indication of future realized losses, which could reduce our income available for distribution. Defaults by our portfolio companies may harm our operating results. Changes in interest rates may affect our cost of capital, the value of our investments and results of operations. Our portfolio may be concentrated in a limited number of portfolio companies and industries, which will subject us to a risk of significant loss if any of these companies defaults on its obligations under any of its debt instruments or if there is a downturn in a particular industry. We may not realize gains from our equity investments. Our investments in asset-backed securities are subject to additional risks.

There is no public market for shares of our common stock, and we do not expect there to be a market for our shares. There are restrictions on the ability of holders of our common stock to transfer shares in excess of the restrictions typically associated with a private placement of securities under Regulation D and other exemptions from registration under the Securities Act, and these additional restrictions could further limit the liquidity of an investment in shares of our common stock and the price at which holders may be able to sell the shares. Provisions of the Maryland General Corporation Law and our charter and bylaws could deter takeover attempts and have an adverse impact on the price of our common stock.

We expect to borrow funds in order to make additional investments, including under the Revolving Credit Facility and other financing arrangements. We expect to use this practice, which is known as "leverage", when the terms and conditions are favorable to long-term investing and well aligned with our investment strategy and portfolio composition in an effort to increase returns to our stockholders, but this strategy involves significant risks. With certain limited exceptions, we are only allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, is at least 150% immediately after each such borrowing. The amount of leverage that we employ will depend on our Investment Adviser's and our Board's assessment of market and other factors at the time of any proposed borrowing.

An investment in BPCC involves significant risks, and an investor may lose all or part of his or her investment. Additionally, there is the potential that distributions may not be paid, may not grow over time, and may include a return of capital.

IRR calculations have an inherent assumption that investors will be able to reinvest any distributions from the investment at the IRR rate. In practice, it is unlikely that this would occur. Another drawback is that in order to calculate IRR for a portfolio that includes holdings that have not yet been sold (or otherwise liquidated or matured), a valuation of those remaining assets must be estimated. Depending on the nature of the asset, these estimated values may be based on subjective factors and assumptions.

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As of March 31, 2023

23-2812230